# COLUMBIA LAW REVIEW.

Published monthly during the Academic Year by Columbia Law Students.

SUBSCRIPTION PRICE, $2.00 PER ANNUM. 30 CENTS PER NUMBER.



# NOTES.

ISSUANCE OF BONDS BELOW PAR CONVERTIBLE INTO FULL-PAID STOCK. Constitutional provisions or the corporation statutes generally forbid the issuance of stock purporting to be full-paid at less than par value in money, labor, or property. *Williams* v. *Evans* (1888) 87 Ala. 725; Gen. Stat. Minn. (1894) § 3415; N. H. Pub. Stat. (1901) ch. 149 § 9; *Donald* v. *Am. Smelting Co.* (1901) 62 N. J. Eq. 729, 731; *Gamble* v. *Water Co.* (1890) 123 N. Y. 91, 106. Contra, Ind. Rev. Stat. (Burns 1901) §§ 3442, 3443; *Stein* v. *Howard* (1884) 65 Cal. 616; *Handley* v. *Stutz* (1891) 139 U. S. 417 and cases cited. Moreover in the absence of express prohibition, the general rule holds an issue of stock below par a fraud on those stockholders who have paid full value, and on creditors who rely on the representation of actual capital. *Sturges* v. *Stetson* (U. S. C. C. 1858) 1 Biss. 246; *Fish* v. *R. R. Co.* (1868) 53 Barb. 513; *Osgood & Moss* v. *King* (1876) 42 Iowa 478. A stockholder may, therefore, because of the negotiability of stock, to prevent irreparable loss to himself, enjoin an unauthorized issue of preferred stock, *Hutton* v. *Scarborough Cliff Hotel Co.* (1865) 2 Drew. & Sm. 514, 521; *Kent* v. *Quicksilver Mining Co.* (1879) 78 N. Y. 159, or an issue of stock as a bonus, *Kraft* v. *Griffon Co.* (N. Y. 1903) 82 App. Div. 29, or an issue of stock below par. *Donald* v. *Am. Smelting Co.* supra, and see 1 COLUMBIA LAW REVIEW 402.

A corporation may issue bonds below par. *In re Anglo-Danubian Steam Navigation Co.* (1875) L. R. 20 Eq. 339; *Gamble* v. *Water Co.* (1890) 123 N. Y. 91, 108. This may be by express statutory authority. Ind. Rev. Stat. (1901) §§ 3442, 3443. Bonds bearing even the highest legal rate of interest may be issued below par if a corporation is prohibited expressly from pleading the usury law as

a defense to its obligations. N. J. Usury Law, Laws 1902 p. 459, see Dill on Corporations 92; N. Y. Rev. Stat. (1901) Interest Law § 16; *Stevens* v. *Watson* (N. Y. 1865) 4 Abb. App. Dec. 302. The same result is reached where a corporation is authorized to borrow money on such terms as may be agreed upon. *Morrison* v. *R. R. Co.* (1860) 14 Ind. 110; *Bank* v. *Manufacturing Co.* (1887) 96 N. C. 298; *Coe* v. *R. R. Co.* (1859) 10 Ohio 372. There is, moreover, authority that even a constitutional prohibition against "fictitious increase of indebtedness" is not violated by an issue of bonds below par for cash. *Northside R. R. Co.* v. *Worthington* (1895) 88 Tex. 562, 573; *Nelson* v. *Hubbard* (1891) 96 Ala. 238, 249–251.

Can a dissenting stockholder restrain the issue of bonds below par, convertible into full-paid stock? In a recent English case the defendant corporation proposed to issue 5% first mortgage debentures at 80 with the right at any time until within six months of maturity, in 1909, to exchange the debentures for fully paid shares to the full nominal amount of the debentures. The plaintiff sought to restrain the issue on the ground that it involved the issuing of shares at a discount. In chancery the injunction was denied on the ground that the scheme was not a colorable device for issuing shares at a discount through the probability of a prompt exchange for stock; that the debentures would constitute property for which shares could be issued according to the defendant's valuation of the property. On appeal it was held that though made in good faith, the agreement would be open to the plaintiff's interpretation and the injunction was granted. The court expressly reserved its opinion as to the right to an injunction in case the bonds had been made convertible at some future date. *Mosely* v. *Koffyfontein Mines* [1904] 2 Chan. 108.

In the absence of statutory or constitutional prohibitions, an implied right to issue convertible bonds has been recognized, if made in good faith. *Baldwin* v. *H. & C. R. R. Co.* (Ohio Dist. Ct. 1853) 1 Ohio Dec. 546; *Van Allen* v. *Ill. Cent. R. R. Co.* (N. Y. 1861) 7 Bosw. 515, aff. (1866) 2 Keyes 673. And for a failure to satisfy the conversion, the corporation is liable in damages. *Chaffee* v. *Middlesex Ry.* (1888) 146 Mass. 224. Although at the time of the bond issue the company has no actual authority to issue more stock. *Bratten* v. *R. R.* (1905) 211 Pa. 21. See also *Belmont* v. *Erie Ry. Co.* (N. Y. 1869) 52 Barb. 637, and *Ramsey* v. *Erie Ry. Co.* (N. Y. 1869) 7 Abb. Prac. N. S. 156.

If in the principal case the demand should be made immediately and new stock should be issued to satisfy the conversion, the effect of the loan would be destroyed and there would be a virtual issue of stock below par, regardless of the bona fides of the directors. But a contract, absolute in its terms, made by a corporation to sell its own stock below par, is valid on its face, and the court will not presume, in the absence of proof, that the stock has not been fully paid up and afterwards acquired by the company. *Otter* v. *Brevoort Petroleum Co.* (1867) 50 Barb. 247. A fortiori, where the contract is performable in the alternative, it would seem that the contract is

valid on its face. In most States a corporation may purchase its own stock, if in good faith, and provided the rights of creditors are not thereby injuriously affected. *First Nat. Bank* v. *Flour-Mills Co.* (1889) 39 Fed. 89, 96 and cases cited; *New England Trust Co.* v. *Abbott* (1894) 162 Mass 148; *Dock* v. *Cordage Co.* (1895) 167 Pa. 370. For other cases, and contra, see 7 Am. & Eng. Enc. 818. It has, morever, been held that a provision for immediate conversion, even where such conversion would amount to an unauthorized increase of stock, will not invalidate the bonds. *Wood* v. *Wheelen* (1879) 93 Ill. 153, 163. The plaintiff in the principal case was unable to show any imminent demand for conversion which would necessarily result in a virtual issue of stock at a discount, or, upon failure to do this, would subject the corporation to payment of damages that would prove a financial loss to him.

If a corporation deliberately violates a rule prescribed by its charter for the benefit of the public, there will be a sufficient cause for forfeiture. As where a bank charges a prohibited rate of interest on loans. *State* v. *Commercial Bank of Manchester* (1857) 33 Miss. 474; *Commonwealth* v. *Commercial Bank* (1857) 28 Pa. 383; *People* v. *Phoenix Bank* (1840) 24 Wend. 431. Or has contracted debts beyond its charter authority. *State Bank* v. *State* (Ind. 1823) 1 Blackf. 267. Provided the misuse of the corporate franchise affects the public. *People* v. *Turnpike Co.* (N. Y. 1807) 2 Johns. 190. Moreover a device, which is intended merely to evade the law, is as much a violation as a direct breach. *Sturges* v. *Stetson* (U. S. C. C. 1858) 1 Biss. 246. Such intention should, however, be alleged, and the jury are to decide upon its existence as a fact. *Commonwealth* v. *Commercial Bank*, supra. An issue of convertible bonds intended as an illegal issue of stock might, therefore, be viewed by the courts as a misuse of the corporate franchise, sufficiently affecting the public—see *Williams* v. *Evans* (1888) 87 Ala. 725, 727, and *Osgood & Moss* v. *King* (1876) 42 Iowa 478, 483—to make the corporation liable to ouster. A dissenting stockholder may enjoin a corporation if it is about to do an act which will subject it to a forfeiture. *Rendall* v. *Crystal Palace Co.* (1858) 4 Kay & Johns. 326; *Pond* v. *Vermont Valley R. R.* (1874) 12 Blatch. 280; *Manderson* v. *Commercial Bank* (1857) 28 Pa. 379. But the dissenting stockholder in the English case was unable to show an intent to evade the law. If by the terms of the bonds the conversion cannot take place for several years, and then only at the election of the bondholders, it would seem still more difficult to show the facts entitling the plaintiff to an injunction.

It would seem, moreover, that if the conversion can take place only after several years, new stock issued to satisfy the conversion would not be issued below par. Full-paid stock may be issued in payment of debts due from the corporation, provided the directors have authority to issue for an equal amount of cash. *Lohman* v. *N. Y. & Erie R. R. Co.* (N. Y. 1848) 2 Sandford 39; *Reed* v. *Hayt* (N. Y. 1884) 19 Jones and Spencer 121. Outstanding bonds, irre-

spective of the consideration paid for them, are valid claims against the corporation to their full face value. If there has been a bona fide loan, the stock will be issued for the surrender of a valid claim of equal value with the par value of the stock. That a corporation's outstanding bonds may be considered as property for which paid up shares may be issued, seems contemplated by the New Jersey statutes. Under them a corporation may issue bonds covertible at par at the option of the holder into fully paid common stock at par within any period therein prescribed, not less than two years from the issue thereof, and in such case the board of directors may authorize the issue of the common stock into which such bonds by their terms shall be convertible. Laws 1902, ch. 58, p. 218. As convertible bonds are not excepted from the provision against pleading usury, supra, it would seem that they might be issued below par. There is, however, no decision on this point. The same result seems intended by the New York statutes. Rev. Stat. (1901) Stock Corporation Law § 2 and the Interest Law, supra. In Indiana the conversion would be lawful at any time. Ind. Rev. Stat. (1901) §§ 3442, 3443.

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FEDERAL TAX ON STATE LIQUOR DISPENSERS.—The Supreme Court has in a recent case limited the exemption of state agencies from national taxation, holding that the liquor dispensers of South Carolina were not a necessary agency of State government, and hence liable to the special tax imposed by the internal revenue laws. *State of South Carolina* v. *U. S.* (1905) 26 Sup. Ct. 110.

There is no express exemption of the agencies of the state or national government from taxation by the other. But the Constitution presupposes the co-existence of the national and state governments. And as the power to tax these means and agencies would involve the power to destroy them and thus work the destruction of the government itself, an exemption from taxation by the other government, is implied by necessity in the Constitution. *McCulloch* v. *Maryland* (1819) 4 Wheat. 316; *Pollock* v. *Farmers Loan & Trust Co.* (1895) 157 U. S. 429, 584; *Collector* v. *Day* (1870) 11 Wall. 113. An exemption by necessity goes no further than the necessity requires. Under this principle a tax that impaired or destroyed a means or agency not necessary to a government, would in no wise affect the protection implied in the Constitution. Whether a means or agency is necessary to a government would seem to depend both on the purpose for which it was established, and on its fitness for this object.

First as regards the exemption of the national government, it would seem that, as it may act only under the Constitution, and as the Constitution presumably grants only necessary powers, the means and agencies employed by the central government are all for strictly governmental purposes, and the question of fitness is the only one before the court. *Osborn* v. *U. S. Bank* (1824) 9 Wheat. 738; *Van Brocklin* v. *Ten-*